UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

PEPSI-COLA METROPOLITAN BOTTLING COMPANY, INC., Plaintiff, v. INSURANCE COMPANY OF NORTH AMERICA, INC.; and ONEBEACON AMERICA INSURANCE COMPANY, Defendants.	CV 10-2696 SVW (MANx) ORDER GRANTING CENTURY'S MOTIONS FOR PARTIAL SUMMARY JUDGMENT REGARDING § 2860 IN PART; DENYING CENTURY'S MOTIONS FOR PARTIAL SUMMARY JUDGMENT IN PART; GRANTING PEPSI'S MOTIONS FOR PARTIAL SUMMARY JUDGMENT IN PART [108], [114], [121], [126], [141], [144]

I. BACKGROUND

A. The Underlying Actions

This is an insurance action stemming from the release of hazardous contaminants from a manufacturing plant in Willits, California ("Willits Site"). The Willits site was owned and operated by Remco Hydraulics, Inc. ("Remco") from about 1948 to 1968, when it was acquired by Stanray Corporation ("Stanray"). Stanray, through a series of acquisitions and mergers that are not currently relevant to these proceedings, eventually merged with Pepsi-Cola Metropolitan Bottling Company ("Pepsi").

Pepsi alleges that it has been sued by more than 1,100 claimants in suits stemming from the contaminants released at the Willits Site. Pepsi hired the law firm of Latham & Watkins ("Latham") to defend it in these suits. The relevant suits, in chronological order, include: Avila, et al. v. Willits Environmental Remediation Trust, et al., No. C-99-3491-SI (N.D. Cal.) ("Avila Suit") (filed August 1999); Arlich, et al. v. Willits Environmental Remediation Trust, et al., No. C-01-0266-SI (N.D. Cal.) ("Arlich Suit") (filed January 2001); Nickerman, et al. v. Remco Hydraulics, Inc., et al., No. C-06-2555-SI (N.D. Cal.) ("Nickerman Suit") (filed April 2006); and Whitlock, et al. v. PepsiAmericas, Inc., No. C-08-2742-SI (N.D. Cal.) ("Whitlock Suit") (filed May 2008). In all of these suits, the plaintiffs seek damages for bodily injury or property damage arising from the release of contaminants from the manufacturing plant in Willits.

B. The Current "Core Dispute"

On behalf of its predecessors, Pepsi asserts four claims against a primary liability insurer, Century Indemnity Company ("Century") as successor to Insurance Company of North America ("INA").[1] Generally speaking, the claims are: (1) a breach of contract claim for failure to reimburse defense costs, (2) a breach of contract claim for failure to pay settlements, (3) a declaratory relief claim seeking to establish its rights and the insurer's duties for future liability from the Willits site, and (4) a tortious breach of the implied covenant of good faith and fair dealing for knowing refusals to pay claims or defense

[1] INA was restructured in 1995, whereby INA allegedly transferred its insuring obligations relating to actual and potential environmental liabilities to CCI Insurance Company, which merged with Century Indemnity Company.

costs and responding to Pepsi's communications. All of these claims arise from Century's alleged duties to defend and duties to indemnify Pepsi for costs and settlements in the Avila, Arlich, Nickerman, and Whitlock suits.

Century has raised a variety of defenses to Pepsi's claims and asserted its own Counterclaims. Century seeks a determination and declaration that it owes no duty to defend Pepsi, that a prior judicial determination of the allocated share of defense costs between insurers is binding, and that Pepsi is required to arbitrate any disputes under California Civil Code § 2860.[2] Second, Century seeks monetary damages

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[2] As discussed in more detail below, § 2860 (c) requires arbitration for attorneys fees fee disputes between an insurer and its insured in certain situations. The section states:

> When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

Cal. Civ. Code § 2860(c).

for unjust enrichment for payments already made to Pepsi that it contends were not due under its policies.[3] Third, Century seeks a determination that it is not obligated to indemnify Pepsi in the underlying suits. Century alleges that pursuant to its reservation of rights, the defense costs incurred by Pepsi were neither reasonable nor necessary pursuant to California Civil Code § 2860.

Further, Century asserts that there is no potential for coverage for any of the Underlying Actions for a variety of reasons, including: (1) that defense costs were voluntarily incurred prior to notice, (2) settlements were voluntarily entered without proper notice, and (3) there is no coverage for the actions under the policy terms. To the extent that there is coverage, Century argues that as per a Statement of Decision After Bench Trial in a Superior Court of California, Century is not obligated to pay more than the judicially-determined allocation of defense costs for Century, which is 12.91%.[4]

C. The Cross-Defendant Dispute

Century has filed Crossclaims against six of Pepsi's primary liability insurers,[5] Travelers Indemnity Company ("Travelers"),

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[3] Roughly speaking, it would appear that Century has reimbursed Pepsi around $5 million in defense costs, which is roughly around 5-10% of the defense payments made by Pepsi.

[4] The case was affirmed in Employers Insurance Company of Wausau v. Travelers Indemnity Company, et al., 141 Cal. App. 4th 398 (2006) ("Wausau").

[5] For the sake of clarity, the Court does not address OneBeacon's claims against Pneumo Abex in this Order. As to Cross-Defendant Pneumo Abex, OneBeacon seeks a declaration that it owes no duty to defend or to indemnify Pneumo Abex and it also seeks damages for unjust enrichment for money paid to Pneumo Abex. This dispute has been addressed in the Court's prior Order granting Pneumo-Abex's Motion to Dismiss, but with leave to amend. (Doc. No. 107). OneBeacon has not amended its complaint.

Continental Insurance Company ("Continental"), Northwestern National Insurance Company of Milwaukee, Wisconsin ("Northwestern"), National Union Fire Insurance Company of Pittsburgh ("National Union"), Employers Insurance Company of Wausau ("Wausau"), and OneBeacon America Insurance Company ("OneBeacon") (Collectively "Third-Party Defendants"). Century has also sued Allstate, an excess insurer.

All of the Third-Party Defendants except for Wausau and OneBeacon settled with Pepsi (at that time, known as Whitman) in 1997 and 1998 to resolve a coverage dispute of environmental claims raised in another case arising from areas including the Willits site. Wausau, 141 Cal. App. 4th at 401. As part of these settlements, Pepsi released the Third-Party Defendants from any obligation to defend or indemnify it against past, present, and future environmental actions. Id. at 401. Pepsi also agreed to indemnify the Third-Party Defendants against any claims by third parties under their policies, including other insurers' claims for contribution. Id. In return, Pepsi received an aggregate of approximately $24 million. Id. at 402. Wausau, OneBeacon, and Century were not parties to the settlement. Wausau filed suit to compel contribution to claims made by Pepsi from the settling insurers in 2005 and the Superior Court determined that the settling insurers were still liable on claims under the Policies, and further, apportioned liability amongst all the insurers, including the non-settling insurers. After the California Court of Appeals upheld the ruling in 2006, Wausau also settled with Pepsi, leaving only OneBeacon and Century outside the scope of the settlements. After the filing of this suit, OneBeacon also settled with Pepsi, leaving Century as the only non-settling primary liability insurer.

Century alleges that these Third-Party Defendants, and each of them, have a duty to defend and indemnify Pepsi for the underlying suits. Century seeks a declaration that to the extent they owe any defense or indemnity to Pepsi, the Third-Party Defendants are responsible for an equitable share of such an award. Century also seeks reimbursement from the Third-Party Defendants for their equitable share of amounts that Defendants have allegedly paid in excess for Pepsi. Essentially, Century seeks contribution, equitable indemnity, or equitable subrogation from these Third-Party Defendants. Century argues that the Third-Party Defendants' liability has been previously adjudicated by the Superior Court and they are estopped from relitigating these issues.

On November 3, 2010, this Court stayed all indemnity-related claims, counterclaims, and crossclaims pending resolution of the underlying suits. On December 13, 2010, the Court also stayed all claims against Allstate, an excess insurer, until the pending "core dispute" between Pepsi and Century is resolved.

II. LEGAL STANDARD

Rule 56(c) requires summary judgment for the moving party when the evidence, viewed in the light most favorable to the nonmoving party, shows that there is no genuine issue as to any material fact, and that the moving party is entitled to judgment as a matter of law. See Fed. R. Civ. P. 56(c); Tarin v. County of Los Angeles, 123 F.3d 1259, 1263 (9th Cir. 1997).

The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. See Celotex Corp v. Catrett, 477 U.S. 317, 323-24 (1986). That burden may be met by

"'showing' -- that is, pointing out to the district court -- that there is an absence of evidence to support the nonmoving party's case." Id. at 325. Once the moving party has met its initial burden, Rule 56(e) requires the nonmoving party to go beyond the pleadings and identify specific facts that show a genuine issue for trial. See id. at 323-34; Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). A scintilla of evidence or evidence that is merely colorable or not significantly probative does not present a genuine issue of material fact. Addisu v. Fred Meyer, 198 F.3d 1130, 1134 (9th Cir. 2000). Only genuine disputes "where the evidence is such that a reasonable jury could return a verdict for the nonmoving party" over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. See Anderson, 477 U.S. at 248; see also Aprin v. Santa Clara Valley Transp. Agency, 261 F.3d 912, 919 (9th Cir. 2001) (the nonmoving party must identify specific evidence from which a reasonable jury could return a verdict in its favor).

III. CURRENT MOTIONS

Century has four pending motions before the Court. First, Century seeks an order to compel arbitration of Pepsi's dispute regarding Century's duty to defend as a fee dispute under Cal. Civ. Code § 2860. (Doc. No. 108). Second, Century seeks partial summary judgment on its declaratory relief claim that Third-Party Defendants must contribute to Pepsi's claims under the Policies as per the Wausau decision. (Doc. No. 114). Third, Century seeks partial summary judgment on its declaratory relief claim asserting the applicability of § 2860 to this suit. (Doc. No. 121). Finally, Century seeks partial summary judgment on its declaratory relief claim that it only needs to contribute its

allocated share as per the Wausau decision in response to Pepsi's claims under the policies. (Doc. No. 126).

Pepsi has two pending motions before the Court. First, Pepsi seeks summary judgment as to Century's affirmative defenses and a finding that §2860 does not apply to this suit. (Doc. No. 141). Second, and somewhat relatedly, Pepsi seeks partial summary judgment as to its claim that Century has breached its duty to defend. (Doc. No. 144).

The Court first reviews Pepsi's Motion for Summary Judgment on Century's breach of its duty to defend before turning to arguments implicating § 2860.

A. Pepsi's Motion for Summary Judgment on Duty to Defend

An insurer's "duty to defend is broader than its duty to indemnify." Buss v. Superior Court, 16 Cal.4th 35, 46 (Cal. 1997). An "insurer's duty to defend runs to claims that are merely potentially covered, in light of facts alleged or otherwise disclosed." Id. It arises as soon as tender is made and it is discharged when the action is concluded or if it is determined that a claim cannot be in fact covered. Id. The duty to defend "requires the incurring of reasonable and necessary [defense] costs" on the part of the insurer. Aerojet-General Corp. v. Transport Indemnity Co., 17 Cal.4th 38, 58 (1977).

"Imposition of an immediate duty to defend is necessary to afford the insured what it is entitled to: the full protection of a defense on its behalf." Montrose Chemical Corp. v. Superior Court, 6 Cal.4th 287, 295 (Cal. 1993). "In purchasing his insurance the insured would reasonably expect that he would stand a better chance of vindication if

supported by the resources and expertise of his insurer than if compelled to handle and finance the presentation of his case. He would, moreover, expect to be able to avoid the time, uncertainty and capital outlay in finding and retaining an attorney of his own." Gray v. Zurich Ins. Co., 65 Cal.2d 263, 278 (1966).

"If the insurer is obliged to take up the defense of its insured, it must do so as soon as possible, both to protect the interests of the insured, and to limit its own exposure to loss. . . . [T]he duty to defend must be assessed at the outset of the case. It follows that a belated offer to pay the costs of defense may mitigate damages but will not cure the initial breach of duty." Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc., 78 Cal.App.4th 847, 881 (Cal.App.1.Dist. 2000) (internal citations and quotations omitted); see also Buss, 16 Cal. 4th at 49 ("To defend meaningfully, the insurer must defend immediately."). "A breach of the duty to defend in itself constitutes only a breach of contract but it may also violate the covenant of good faith and fair dealing where it involves unreasonable conduct or an action taken without proper cause." Shade Foods, 78 Cal. App. 4th at 881. "The general measure of damages for breach of duty to defend consists of the insured's cost of defense in the underlying action, including attorney fees." Intergulf Development v. Superior Court,107 Cal.Rptr.3d 162, 165, 183 Cal.App.4th 16, 20 (Cal. App. 4 Dist. March 24, 2010).

It is undisputed that Century's insurance policies contain a clause whereby Century has agreed to provide a defense for its insured in third-party actions based on potentially covered risks. In fact, Pepsi does not contend that Century failed to acknowledge its duty to

provide Pepsi a defense for the underlying lawsuits in a timely manner. However, Pepsi's essential allegation is that despite acknowledging its duties, Century did not carry out its duties in a reasonable fashion.

Pepsi's Motion for Summary Judgment on Century's breach of its duty to defend is based upon four principal arguments, alleging either that Century failed to defend Pepsi "immediately" or "entirely" as required by California law. First, Pepsi argues that Century failed to timely pay for Pepsi's defense and in some instances, waited over to two years before it paid even a fraction of Pepsi's tendered bills. Second, Pepsi alleges that Century unilaterally and improperly decided to only reimburse Pepsi for 12.91% of its defense costs, despite the Superior Court allocating order in a suit filed by Wausau. Third, Pepsi argues that Century improperly applied Wausau's billing guidelines in either refusing to pay certain costs or reducing bill payments. Finally, Pepsi alleges that Century improperly "slashed" the hourly rates charged by Latham.

(1) Failure to Defend "Immediately"

Century argues that California law does not require that an insurer immediately pay defense costs for *Cumis* counse without a proper investigation. Though there is some support for Century's argument, the requirement that an insurer provide an "immediate" defense is not so easily satisfied that an insurer need only recognize its duty to defend an insured in a timely fashion and then engage in investigations in perpetuity. The insurer must *actually defend* its insured in a reasonably timely fashion, including by timely paying reasonable and necessary fees for *Cumis* counsel when appropriate. Although California law may not require an insurer to blindly pay unreasonable and

unnecessary *Cumis* defense costs for obvious reasons,[6] *unreasonable delays* are undoubtedly grounds for a breach of the insurer's duty to defend. Intergulf,183 Cal.App.4th at 20 ("Unreasonable delay in paying policy benefits or paying less than the amount due is actionable withholding of benefits which may constitute a breach of contract as well as bad faith giving rise to damages in tort."). Such delays could effectively deprive the insured of its entitled defense under its bargained-for agreement with the insurer.

Pepsi has put forth the declaration of Evy M. Wild in support of its arguments that Century has breached its duty to defend and the covenant for good faith and fair dealing as a matter of law. (Doc. No. 147) ("Wild Decl."). As the Wild Declaration is central to Pepsi's Motion because it purports to identify all of the requests sent by Pepsi to Century for defense costs, the amounts of these defense costs, the date these requests were sent, the time it took for Century to respond, and the amount paid by Century, it is appropriate to discuss its admissibility at the outset.

Century objects to the Wild Declaration and attached Exhibits 2 and 3, which contain Pepsi's records of its defense costs, the date and amount of invoices sent to Century, as well as the date and amount of payments made by Century. Century's objections are primarily based on the fact that it believes Wild's testimony is without personal

[6] As stated in United Pacific v. Hall, 199 Cal.App.3d 551, 557 (1988), while "*Cumis* may prohibit an insurer from dictating the tactics of litigation, it does not delegate to *Cumis* counsel a meal ticket immunized from judicial review for reasonableness."

knowledge, and is based on unauthenticated records.[7] Wild is the director of a financial consulting firm in Los Angeles, California, which has been retained by Howrey, Pepsi's counsel, to collect, review, track, and analyze Pepsi's defense costs in the underlying suits. Wild Decl. ¶ 3. Wild's firm receives the documentation needed to perform these tasks from Howrey, and Wild is personally involved in reviewing and analyzing the data as part of her regular responsibilities. Wild Decl. ¶ 4. Wild prepared charts containing the relevant information regarding Century's delay in responding to invoices, attached in Exhibit 2 and 3 of her declaration. Wild Decl. ¶¶ 9-10. Wild used the dates indicated on checks from insurer's payments in her analysis. Wild Supp. Decl. ¶ 3. Wild attached copies of checks from Century and copies of related correspondence in support of her declaration. See, e.g., Wild Decl. Ex. 44. The attached correspondence is on the official letterhead of Century's firm, signed by an attorney and dated. The attached correspondence references the invoices that relate to the payments being made. The attached checks contain dates. Century does not object to the admission of these checks and letters.

The party offering the evidence has the burden of presenting sufficient evidence showing that the evidence is what is purported to be. Fed. R. Evid., Rule 901(a). Documentary evidence may be authenticated by a knowledgeable witness. Fed. R. Evid., Rule 901(b)(1). Here, Wild has herself stated that she herself prepared the charts and a "true and correct copy" is attached. Wild Decl. ¶¶ 9-10.

[7] Century also makes evidentiary objects to the Declarations of David S. Cox and Troy L. Chute, which were made in support of Pepsi's Motion. However, Century's objections relate to collateral matters, the Court focuses on the testimony legally relevant to this Motion.

Further, as Century does not dispute the admissibility of the exhibits on which Wild bases her charts, the Court itself can determine the delays between tender and payments. Any hearsay objections regarding Wild's reliance on the letters are also meritless, as the letters themselves are authenticated and are clearly party admissions.

Having found that the charts are admissible, the Court now turns to whether any factual disputes exist as to whether the delays were unreasonable. Some of the delays highlighted in the Wild Declration are egregious. In some instances, Century waited almost two years before it paid an invoice. The average delay in paying an invoice has been over one year for the Avila and Arlich suits between 2003 and 2009. For the Nickerman suit, Century's average delay appears to be close to a year. Similarly, for the Whitlock suit, Century has waited over a year to reimburse Pepsi for the last two requests submitted by Pepsi.

The evidence establishes that for the Avila, Arlich, Nickerman and Whitlock suits, Century has breached its duty to defend through its pattern of delaying its reimbursements to Pepsi. Although the Court does not find that California law requires that an insurer must blindly pay even unreasonable and unnecessary *Cumis* fees immediately as a matter of law, here, Century has not offered any evidence to show its year-long, and in some instances, two year-long delays could be reasonable.[8] Though it is clear that the underlying suits created

[8] Pepsi cites to California Code of Regulations, Title 10, Chapter 5, Subchapter 8, § 2695.7 (b), which states that in "no event more than forty (40) calendar days later, [an insurer must] accept or deny the claim, in whole or in part." Although this regulation has not been applied in the duty to defend context, it is at least some indication of the timeframe considered reasonable in responding to an insured's claim under a policy.

voluminous records of attorneys' fees for Century to review in determining which fees were reasonable and necessary, Century has not offered any persuasive evidence showing that it attempted to investigate these bills in a timely manner or that delays of greater than one year were reasonable to rebut the evidence presented by Pepsi. Moreover, a merely colorable theory that the voluminous records could have caused such delays even for a sophisticated insurer does not present a genuine issue of material fact. Although the Court finds that Century's delay in responding to Pepsi's reimbursement requests was a breach of the duty to defend, the amount of damages remains to be proven.[9]

(2) Failure to Defend "Entirely"

Pepsi cites to Buss for the general principle that an insurer must defend an action "entirely" under its duty to defend, and by failing to pay **all** *Cumis* fees, Century has breached its duty to defend. Buss, 16 Cal. 4th at 49 ("To defend meaningfully, the insurer must defend immediately. To defend immediately, it must defend entirely.") (citation omitted). This principle was announced in the context of an insurer parsing potentially covered claims and potentially uncovered claims in its defense of an insured's case ("mixed"cases). The Buss court announced the principle that in such a "mixed" action, the insurer must defend the entire action so as not to prejudice the

[9] The general breach of contract damages for a breach of the duty to defend would include a determination of reasonable and necessary attorneys fees and costs. This amount remains to be proven. The Court notes that Pepsi may attempt to seek consequential damages. At this time, however, Pepsi has not shown that it was forced to hire other counsel and nor does it claim that its defense was prejudiced as a result of delays by Century. In fact, Pepsi retained Latham throughout its litigation and paid Latham's defense costs.

insured in its time of need, but may seek reimbursement for claims that were never even potentially covered. Id. at 49-53.

Regardless of whether a case is "mixed," the general principle announced in Buss applies when an insurer refuses to pay all the defense costs for the reason that the insured also has *other* coverage. "[W]hile each of the insurers 'on the risk' has a duty to defend the action in its entirety and the duty is separate and independent from the other insurers, each also has a 'corresponding right of some sort to require the others to share in discharging the duty or at least contribute to its costs.'" Croskey, Heeseman & Popik, Cal. Prac. Guide: Insurance Litigation (The Rutter Group 2009), at ¶ 7:677.1 (quoting Aerojet-General Corp. v. Transport Indem. Co., 17 Cal. 4th 38, 70 (1997)). Similarly, in the context of an indemnification dispute between an insured and an insurer, California courts have held that even if multiple policies are triggered on a single claim, the insurer's right to contribution "has no bearing upon the insurers' obligations to the policyholder. . . . to cover the full extent of the policyholder's liability (up to the policy limits)." Dart Industries, Inc. v. Commercial Union Ins. Co., 28 Cal. 4th 1059, 1080 (2002); Armstrong World Indus. v. Aetna Cas. and Sur. Co., 45 Cal. App.4th 1, 52 (1996) ("[A] policyholder may obtain full indemnification and defense from one insurer, leaving the targeted insurer to seek contribution from other insurers covering the same loss.") (quotations omitted). Further, an insurer's failure to pay the full amount of reasonable and necessary defense costs based on the contention that there may be other coverage available is a breach of the duty to defend. Croskey, Heeseman & Popik, Cal. Prac. Guide: Insurance

Litigation (The Rutter Group 2008), at ¶ 7:631 ("Where several insurers share the risk, each owes a duty to defend the *entire* action . . . an insurer who at the outset accepts 'only its pro-rata share' of defense costs is in effect breaching its duty to defend.") (citing Haskel, Inc. v. Sup. Ct. (Aetna Cas. & Sur. Co.) (1995) 33 CA 4th 963, 976, 39 CR2d 520, 526, fn. 9). The reasoning behind this rule is to protect the insured. In finding that the duty to defend is an independent and bargained-for benefit under each applicable insurance contract when multiple insurers cover the same risk, California courts have left battles of allocation of costs to separate contribution suits between liability insurers, rather than subjecting the insured to additional litigation.

Century argues that the principle that an insurer must defend the entire action does not have any bearing on the special facts of this case. Here, not only has apportionment already occurred with a final determination that Century has an equitable right of contribution, but Century contends that it would effectively receive all costs paid greater than the amount required by the allocation back from Pepsi itself. It appears that Pepsi settled with Third-Party Defendants by allowing them to "buy back" their policies. However, the Wausau court found that this settlement did not eliminate the settling insurers' liability to non-settling insurers for equitable contribution for costs and claims paid on the same risk covered by all the insurers. Wausau, 141 Cal. App. 4th at 405-06. As such, the Wausau court upheld a 2005 Allocation Order of the Superior Court apportioning defense costs between insurers, including Century, which shared 25.81% of the defense costs with OneBeacon under the prior order based upon a time-on-the-

risk analysis. Id. at 406. Although the remaining settling insurers were also held to be responsible for defense costs, as per the settlement agreements, Pepsi has promised to indemnify the settling insurers for any claims under the policy, including defense costs. Century contends that Pepsi is estopped from arguing otherwise. Thus, according to Century, the effect of requiring Century to pay all the defense costs in this case would require a needless procedure: Century would receive equitable contribution from the settling insurers based on its rights and the allocations as determined by the Wausau court, and the settling insurers would then receive indemnification from Pepsi for the amounts contributed to Century.

However, Century's reasoning is flawed because there has been no judicial determination regarding all of the effects of Pepsi's settlement agreements as between Pepsi and the settling insurers, and further, Century may not be entitled to contribution from all the insurers. First, though the Wausau court allocated contribution rights amongst the insurers, it did not fully analyze the legal effect of each of the settlement agreements on Pepsi. If this Court were to assume that the settlement agreements operate as Century suggests they do, the Court could preclude possible legal defenses and claims under the agreements that Pepsi may assert against settling insurers seeking indemnification. Thus, though the Wausau court's rulings may be binding as to insurers' *contribution* rights, it did not fully address Pepsi's *indemnification* liabilities under the agreements. These contractual interpretation issues are not currently before the Court on summary judgment.

Second, though the Wausau court also found that the underlying

policies covered by the settlements were not exhausted simply because the settlement agreements deemed the underlying insurance policies to be "exhausted," the Wausau court did not and could not have determined whether some of the policies would actually exhaust through settlements and liability determinations in the underlying suits.[10] In this case, various settlements with third parties involved in the underlying suits may have exhausted some of the policies since the ruling in Wausau, thereby possibly terminating an insurer's duty to defend. Croskey, Heeseman & Popik, Cal. Prac. Guide: Insurance Litigation (The Rutter Group 2009), at ¶ 7:652 ("Exhaustion of policy limits by payment of a settlement or judgment against the insured may terminate any further defense duty."). Further, the underlying policies had different terms and limits – some may have had caps on defense costs, while others may not. Naturally, Pepsi's liabilities under its settlement agreements would change based on which policies were exhausted and the interpretation of its settlement agreements and policies themselves. If at some point, one of the policies became exhausted, Pepsi could have no obligation to indemnify an insurer because the insurer could have defenses to contribution sought by Century; therefore, Century could remain liable to Pepsi under its duty to defend for an amount greater than 12.91% of the defense costs.

Thus, the seemingly needless procedure of providing defense costs on one hand and receiving the same money back from Pepsi through the other hand would not take place under a scenario where either some or all of the policies have been exhausted or Pepsi has a defense to

[10] The issue of the preclusive effect of the 2005 Allocation Order and whether it addressed exhaustion is discussed further in Section III, Part C.

indemnification of some or all of the settling insurers. Further, Century has not provided the Court with the information to properly determine whether none of the policies have yet exhausted.[11] Even if the Court had such information, embarking on such a challenge, while also substantively determining the legal effect of Pepsi's settlement agreements, would deprive Pepsi of its bargained-for benefit to a full and timely defense by *each* insurer and would subject Pepsi to a litigation war on two fronts. Therefore, the Court finds that Century breached its duty to defend Pepsi by insisting that it only needed to reimburse 12.91% of the defense costs in maximum, despite its reliance on an allocation order determining the insurer's rights to contribution amongst themselves.

Pepsi also argues that Century's reliance on Wausau's "billing guidelines" was improper, and that Century breached its duty to defend when it "slashed" Latham's hourly rates.[12] Essentially, Pepsi argues that by reducing its rates under the billing guidelines and other standards, Century violated its duty to defend and impinged upon Latham's independent professional judgment in rendering legal services as *Cumis* counsel. Pepsi asserts that Century has attempted to regain control of counsel through the application of these guidelines – a

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[11] Pepsi has submitted the Declaration of Troy L. Chute, in which Chute presens records of the exhaustion of certain of the policies for bodily injury arising out of Willits Chute states that the *only* remaining unexhausted primary coverage is the policies remaining for OneBeacon and Century. However, the impact of Pepsi's recent settlement with OneBeacon is unclear.

[12] In some instances, Latham charged over $800 per hour for its partners. Century appears to have cut these rates roughly in half in some instances based on its experience with counsel's rates in similar cases.

violation of *Cumis* principles as well as a basis for a breach of Century's duty to defend. Pepsi specifically objects to the audits performed by Wausau's independent auditors, the Flores Group. The Flores Group utilized Wausau's "billing guidelines" in recommending various reductions in payments of Latham's bills. For example, the Flores Group rejected bills in a certain "block billing" format, for time billed in conferences, for alleged activities which may not have actually occurred, overhead costs, and excessive research costs (just to name a few). Declaration of David S. Cox, Ex. 1. at 5-8; Ex. 2, 12-17.

Pepsi can cite no binding law for the proposition that the insurer's reduction of *Cumis* fees based on standardized "billing guidelines" is a breach of the duty to defend rather than a dispute over the amount of "reasonable and necessary" defense costs. Century contends that its application of "billing guidelines" is essentially a *Cumis* fee dispute to be arbitrated under § 2860, and not a question of a breach of Century's duty to defend the action "entirely."[13]

This Court agrees that the use of "billing guidelines" and reducing hourly rates was not a breach of the duty to defend in this case, but addresses the question of whether the dispute can be sent to arbitration in Part B. Such guidelines may not "be permitted to impede [*Cumis* counsel's] professional judgment about how best to competently represent the insureds." Dynamic Concepts, Inc. v. Truck Ins. Exch., 61 Cal. App. 4th 999, 1009 (Cal. App. 4d 1998). However, the evidence

[13] At least one court has found that a strategy-neutral application of "billing guidelines" and third-party audits of *Cumis* fees by an insurer are subject to § 2860(c) arbitration and does not amount to a breach of an insurer's duty to defend. See Wallis v. Centennial Ins. Co., 2010 WL 2612734 at *2 (E.D. Cal. June, 2010) (Shubb, D.J.).

does not show that the "billing guidelines" were applied in a manner that influenced Latham's substantive strategy decisions, but instead, it appears that the purpose and result of the guidelines is to reduce overall fees based on objective standards relating to billing practices. Much like reducing the overall hourly billing rates under § 2860 to conform with those ordinarily charged in the community, the application of the guidelines in this case appears to turn on reducing costs that the insurer finds needless or unexplained, under strategy-neutral criteria. The insurers in this case further separated themselves from direct involvement in the management of Pepsi's case by hiring a third-party auditing group, Flores, to make recommendations regarding the areas where Flores determined costs were duplicative, excessive, or unnecessary. A finding that insurers must pay even unreasonable and unnecessary defense costs would fly in the face of California law. See Gray Cary Ware & Freidenrich v. Vigilant Insurance Co., 114 Cal.App.4th 1185, 1189 (Cal. App. 4d 2004) ("[The] duty [to defend] includes providing competent counsel and paying all reasonable and necessary costs."); Aerojet, 17 Cal.4th at 58 ("[The duty to defend] requires the incurring of reasonable and necessary [defense] costs.").

In conclusion, there is no genuine dispute of material fact surrounding Century's breach of its duty to defend by unreasonably delaying defense cost payments and capping payments at 12.91% of the total defense costs. Accordingly, Pepsi's Motion for Partial Summary Judgment on Duty to Defend is GRANTED. For the same reasons, Century's Motion for Partial Summary Judgment of Declaratory Relief Re: Allocation of Defense Costs Against Plaintiff is DENIED. In making

this determination, the Court does not rely on Pepsi's other arguments. Specifically, Pepsi's argument that Century improperly cut fees by applying billing guidelines and reduced hourly rates is ultimately a dispute over whether the incurred defense costs are reasonable and necessary, and does not rise to the level of a breach of a duty to defend.

B. Century's Motion to Compel Arbitration Under § 2860

Pepsi argues that under recent California law, the dispute over the application of "billing guidelines" and cutting of Latham's hourly rates must be resolved before this Court. Century responds that controlling California law requires that such disputes be resolved through binding arbitration. In deciding this issue, this Court "must approximate state law as closely as possible in order to make sure that the vindication of the state right is without discrimination because of the federal forum." Orkin v. Taylor, 487 F.3d 734, 741 (9th Cir. 2007) (quotations and citations omitted). Thus, this Court must follow the California Supreme Court's pronouncements, or if the California Supreme Court has not addressed the question, "we must predict how the Court will decide the issue, based on decisions of [California] courts, decisions from other jurisdictions, treatises, and restatements." Matsuura v. Alston & Bird, 166 F.3d 1006, 1008 n.3 (9th Cir. 1999) (per curiam).

California law has long recognized that in certain situations, counsel hired by an insurer to defend its insured may have a conflict of interest. In such an event, California law allows an insured to select independent counsel at the expense of the insurer ("*Cumis* counsel") subject to the limitations of California Civil Code, Section

2860(c), which states:

> When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. *The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended*. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. *Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator* selected by the parties to the dispute.
>
> Cal. Civ. Code § 2860(c) (emphasis added).

Pepsi contends that the California Court of Appeals has found that a court must first decide preliminary questions of duty to defend prior to compelling § 2860 arbitration, and further, that if the court determines there has been a breach of the duty to defend, a liability insurer may not take advantage of the protections and limitations set forth in § 2860. Intergulf,183 Cal.App.4th at 20. Section 2860 itself contains no such requirements.

In Intergulf, an insured sued its insurer for bad faith and breach of contract because, although the insured requested *Cumis* counsel, the insurer never responded to the insured's request. Id. at

19. Over a year after tendering the request and submitting defense costs, the insured filed suit against the insurer and only then did the insurer make two lump sum payments towards defense costs. Id. The insurer then sought to compel arbitration for what it characterized as a *Cumis* fee dispute between it and its insured, under the purview of § 2860(c). Id. The court reasoned that the insured's "entitlement to damages for breach of contract and bad faith turns on: (1) whether [the insurer] owed [the insured] a duty to defend in the first instance; and (2) whether [the insurer] breached that duty by failing to defend [the insured] 'immediately' and 'entirely' on tender of the defense." Id. at 21 (citations omitted). The Intergulf court held that the insured would be prejudiced if the insurer could avail itself of § 2860(c) before the question of duty to defend and breach raised by the insured were determined by the trial court. Id. at 21-22. The court found that unlike other cases, the present dispute was not over the amount or hourly rate to be paid to independent counsel. Id. at 22. Instead, the insured's breach of contract and bad faith claims were based on the factual question of whether the insurer "failed to accept [the insured's] selection of independent counsel and pay its share of defense costs in a timely manner." Id.

The Intergulf court specifically stated that it did not disagree with the holdings of Compulink Management Center, Inc. v. St. Paul Fire & Marine Ins. Co., 169 Cal. App. 4th 289, 87 Cal. Rptr. 3d 72 (2008), and Long v. Century Indemnity Co., 163 Cal. App. 4th 1460, 78 Cal. Rptr. 3d 483 (2008). Id. at 21. This affirmation of Compulink poses some

perplexing questions.[14] In Compulink, the California Court of Appeals granted a motion to compel arbitration under § 2860 (c) even though the insured claimed the insurer failed to accept a timely defense, underpaid legal fees, reneged on agreements regarding fees, impeded settlements, and refused to contribute to settlements. Compulink, 169 Cal. App. 4th at 293. The Compulink court reasoned that "the presence of other non-arbitrable issues in an action does not preclude arbitration of *Cumis* fee issues, as long as any disputed matters regarding the duty to defend . . . are resolved by the trial court." Id. at 300. The Court found that "[w]hile [the insured's] complaint alleges wrongful conduct beyond the mere failure to pay attorney's fees, the parties do not dispute that the amount of attorney's fees owed by [the insurer] is a contested issue in this action. Pursuant to section 2860, subdivision (c), that issue must be resolved by an arbitrator . . .. [the bad faith settlement claims] fall outside the scope of section 2860's arbitration provision, and thus are to be adjudicated in the trial court." Id. at 300. Thus, under Compulink, the proceedings would take place on two parallel tracks – the issues of bad faith and breach of the duty to defend would remain with the trial court, while the alleged *Cumis* fee dispute would be

[14] The Court is more concerned with the interplay between Intergulf and Compulink rather than Long, in which the California Court of Appeal faced a more distinguishable scenario. The Long decision involved a suit by an attorney against Century seeking attorneys' fees not subject to the cap of §2860(c), and the "gravamen of the breach-of-implied-covenant claim [was that the attorney] was not paid the hourly rate he sought." Long, 163 Cal. App. 4th at 1466 n.5. In this suit, however, Pepsi has alleged that Century has failed to make timely payments, in some cases, taking over two years to pay tendered legal fees. Further, Pepsi has alleged, and the Court has found, that Century in fact has breached its duty to defend by insisting it is only obligated to pay 12.91% of Pepsi's defense costs at maximum and by delaying defense payments. Thus, Pepsi's suit is not just "plainly [] over the amount of fees paid." Id.

arbitrated. Id.

The Intergulf court distinguished Compulink on the basis that Compulink did not "involve the preliminary question of duty to defend or [a] dispute[] over if and when the insurer recognized the insured's right to select independent counsel." Intergulf, 183 Cal. App. 4th at 21. Further, according to the Intergulf court, Compulink was distinguishable because "the insurer agreed to allow Compulink to select independent counsel to defend the third party suit, and Compulink's complaint for breach of contact and bad faith expressly alleged that the insurer underpaid attorney fees and costs." Id. at 22. The Intergulf court emphasized this was "a distinction *with* a difference." Id. (emphasis in original). Both Intergulf and Compulink involved substantial allegations by the insured of a complete breach of the insured's duty to defend. The Compulink court explicitly recognized that § 2860(c) does not only apply when the "sole issue in dispute is the amount or rate of *Cumis* counsel's fees," rather, it held that "*Cumis* fees questions ***must*** be arbitrated" even if there are additional allegations. Compulink, 169 Cal. App. 4th at 300 (emphasis added). In Compulink, the court principally interpreted the plain meaning of § 2860 to find that § 2860 mandated arbitration of any fee dispute, while the insurer's other claims would be allowed to proceed to trial.[15]

[15] The plain meaning statutory interpretation approach in determining the meaning of §2860(c) has also been employed by the California Court of Appeal in Gray Cary Ware & Freidenrich v. Vigilant Ins. Co., 114 Cal. App. 4th 1185 (Cal. App. 4d 2004). In Gray Cary, the court was faced with the issue of determining whether §2860(c) required arbitration of disputes concerning independent counsel's costs, in addition to "attorney[ ] fees" as stated in the statute itself. Id. at 1192-93. Though the court noted that § 2860(c) does not define "attorney[ ] fees," attorney costs are specifically distinguished from attorney fees in other portions of California codes, and "had

Compulink, 169 Cal. App. 4th at 300. However, in dicta, the Intergulf court noted that if the suit was parsed as in Compulink, the insured could be prejudiced because the arbitrator could determine that the insured's counsel charged fees far in excess of the amounts actually paid by the insurer in the ordinary course of business in similar actions *before* any trial court determination on a breach of the duty to defend.[16] Intergulf, 183 Cal. App. 4th at 22. According to the Intergulf court, in such an instance, it would be unfair to allow an insurer to benefit from the § 2860(c) rate cap even if it is later determined that the insurer breached its duty to defend. Id.

The only reasonable way to give meaning to distinctions between Compulink and Intergulf, while acknowledging the Intergulf court's explicit affirmation of Compulink, is to find that § 2860(c) must apply to a *Cumis* fee dispute as long as an insurer timely acknowledges its duty to pay for *Cumis* counsel, however, if the insurer does not, then Intergulf mandates that the protections of § 2860(c) do not apply. In Intergulf, the insurer only acknowledged its duty to provide *Cumis* counsel years after the insurer was informed that the insured was invoking § 2860, and only after the insured filed suit against the insurer.[17] Id. at 19. In Compulink, however, the insurer acknowledged

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the Legislature intended to require the arbitration of *Cumis* defense expenses as well as *Cumis* attorney fees, it could have so specified." Id. at 1193. Thus, under Gary Cary, attorney costs would fall outside of § 2860(c) arbitration, which is in accordance with the Compulink court's textual approach to interpreting the intent behind § 2860(c).

[16] The Intergulf court's dicta relied neither on the language nor the intent behind § 2860(c).

[17] Arguably, the insurer may never have acknowledged its duty to provide independent counsel in Intergulf. Id.

its duty to provide *Cumis* counsel in a timely fashion and the issue of whether § 2860(c) would apply even if an insurer did not timely acknowledge its insured's right to *Cumis* counsel was not before the court. Compulink, 169 Cal. App. 4th at 293. It is worth repeating that the importance of this distinction is stressed clearly in Intergulf itself, which states Compulink is distinguishable because it did not involve the "preliminary question of duty to defend or disputes over if and when the insurer recognized the insured's right to select independent counsel." Intergulf, 183 Cal. App. 4th at 21. The distinction highlighted by the Intergulf court in distinguishing Compulink is supported by a reasonable construction of § 2860(c) itself. It is implicit that a statute that requires the recognition of independent counsel in situations of a conflict of interest, and thereafter provides for arbitration to resolve fee disputes between insurers and independent counsel, would only require arbitration if the insurer actually recognized the insured's right to independent counsel in the first place. See §§ 2860(a)-(c).

In this case, Pepsi does not allege that Century failed to timely acknowledge Pepsi's right to independent counsel under § 2860(c). As such, the dispute regarding whether Century improperly reduced Latham's billed hours and cut Latham's hourly rates is subject to § 2860(c) arbitration. However, as noted above, both Intergulf and Compulink would require the issues of the breach of the duty to defend and bad faith to remain with this Court.[18]

[18] Although it appears that the Intergulf court may have broken with the Compulink court in requiring that issues regarding the duty to defend and bad faith be addressed *prior to* arbitration under § 2860(c), this Court is not in a position to address that subject. Intergulf, 183 Cal. App. 4th at 22. Due to the procedural posture of

Pepsi argues that the Court should give the dicta in Intergulf – that any breach of the duty to defend blocks the availability of § 2860(c) – more weight than the analysis in Compulink despite the Intergulf court's own affirmance of Compulink. First, Pepsi argues that other federal district courts have held that § 2860(c) only applies if an insurer has not breached its duty to defend. Pepsi relies primarily on Atmel Corp. v. St. Paul Fire & Marine, 426 F. Supp. 2d 1039, 1047 (N.D. Cal. 2005), which held that "if plaintiff is able to establish a breach of the duty to defend, its damages are not limited by California Civil Code § 2860." The Atmel court quoted Concept Enterprises, Inc. v. Hartford Ins. Co. Of the Midwest, 2001 U.S. Dist. LEXIS 6901, 2001 WL 34050685, at *3 (C.D. Cal. May 22, 2001) which states, "To take advantage of the provisions of § 2860, an insurer must meet its duty to defend and accept tender of the insured's defense, subject to a reservation of rights." Though these cases appeal to a certain sense of fairness – that an insurer shirking its duties should not be given the protections of § 2860(c) and the rate cap imposed therein – these cases do not rely on any clear California law or the language of § 2860(c) itself in coming to these conclusions. Only the Atmel case cites to any California law, State v. Pacific Indem. Co., 63 Cal. App. 4th 1535, 1544 (Cal. App. 2d 1998) ("Pacific"), where the California Court of Appeals inherently conceded the trial court's finding that after a breach of duty to defend, an insurer could not assert rates to be paid for defense should be capped at rates ordinarily paid by insurer. However, as acknowledged in Atmel itself, the Pacific case did not squarely address

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this case, the Court has simultaneously addressed the duty to defend question with Century's Motion to Compel Arbitration.

the issue but merely noted in passing that the trial court found that § 2860 did not apply, unlike Compulink and Intergulf, which focus on the issue. Atmel, 426 F. Supp. 2d at 1047. Moreover, Atmel predates both Compulink and Intergulf.[19] As noted earlier, this Court is tasked with approximating the meaning of state law, based on decisions of the state courts. As such, Pepsi's argument is unavailing.

Second, Pepsi argues that the dicta in Intergulf deserves some weight because the procedural posture of Intergulf supports the view that the California Supreme Court favored a finding that § 2860(c) should not apply if an insurer breaches its duty to defend for any reason, rather than just by failing to acknowledge an insured's right to independent counsel. Pepsi argues that the Superior Court in Intergulf cited Long and Compulink in granting an insurer's petition to compel arbitration and continued the trial pending completion of arbitration. Intergulf, 183 Cal. App. 4th at 19-20. The insured in Intergulf then challenged the ruling by filing a writ of mandate in the California Court of Appeal, which was summarily denied for unexplained reasons. Id. at 20. The California Supreme Court then granted the insured's Petition for Review and transferred the matter back to the California Court of Appeal with directions to vacate the order denying mandate and issue an order to show cause why the relief sought should not be

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[19] Another recent federal district court case addresses this issue, but incorporates the same deficiencies as Atmel. In Seagate Technology LLC v. National Union Fire Ins. Co. of Pittsburgh, PA, __ F.Supp.2d __, 2010 WL 2898299, at *4 (N.D.Cal. July 21, 2010), the court comes to the same conclusion as Atmel by citing only Concept Enterprises, a federal court decision, and Pacific, a California case that does not squarely address the issue. The Seagate court does not discuss Compulink or Intergulf.

granted. Id. The language of the decision of the California Supreme Court, however, does not suggest that the California Supreme Court favored a rule barring the application of § 2860(c) when there is a breach of the duty to defend for any reason. The decision, in its entirety, states:

> The petition for review is granted.
>
> The matter is transferred to the Court of Appeal, Fourth Appellate District, Division One, with directions to vacate its order denying mandate and to issue an order directing respondent superior court to show cause why the relief sought in the petition should not be granted.

Intergulf Development (Kettner), LLC. v. S.C. (Interstate Fire & Casualty Company), 2009 Cal. LEXIS 11461 (Oct. 28, 2009).

The inferences suggested by Pepsi are speculative and indiscernible from the opinion of the Supreme Court of California. The Court may have simply been directing the Court of Appeal to explain its reasoning in earlier denying the writ, rather than directing the Court of Appeal to change California law as Pepsi suggests.

Accordingly, the Court GRANTS Century's Motion to Compel Arbitration, but issues aside from the reduction of Latham's hours and the dispute over Latham's hourly rate will remain with the Court. Further, for the same reasons above, the Court GRANTS Century's Summary Judgment Motion seeking an order stating that § 2860 applies in this action to the portion of the dispute over *Cumis* attorney fees.

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C. Century's Motion Regarding the Estoppel Effect of the Prior Allocation Order on Cross-Defendants

Century has moved for an Order declaring that the allocation set out by the Superior Court ("2005 Allocation Order") is still binding on the settling insurers, and that the allocation order and judgment specifically found that the settling insurers' policies were not exhausted; and therefore, that the settling insurers owe their allocated shares to Pepsi.

Under California law, a litigant must have had an appropriate opportunity to litigate an issue in the earlier suit before he or she will be issue-precluded, or collaterally estopped, from relitigating that issue in a later suit. Kougasian v. TMSL, Inc., 359 F.3d 1136, 1143 (9th Cir. 2004). If applicable, collateral estoppel operates as an estoppel or conclusive adjudication as to such issues in the second action that were actually litigated and determined in the first action. Preciado v. County of Ventura, 143 Cal. App. 3d 783, 786–787, fn. 2 (1982).

Collateral estoppel applies when the following test is met:

> First, the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding. Second, this issue must have been actually litigated in the former proceeding. Third, it must have been necessarily decided in the former proceeding. Fourth, the decision in the former proceeding must be final and on the merits. Finally, the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding.

Lucido v. Superior Court, 51 Cal.3d 335, 341 (1990).

In this case, the Court need not move beyond the first and second elements in denying that the 2005 Allocation Order has the preclusive effect sought by Century: that an affirmative determination had been made that the settling insurers' policies were not exhausted. As previously discussed in Section III, Part A(2), it does not appear that the issue of actual exhaustion was identical to any issue raised or actually litigated in the Superior court.[20] The 2005 Allocation Order makes no finding on exhaustion – instead, it only makes a finding of allocation percentages. The Superior Court and the Wausau appellate decision both hold that a mere settlement between an insurer and its insured stating that underlying policies are held to be exhausted does not bar another insurer from exercising equitable contribution rights against the settling insurer; however, these courts do not make a determination regarding the exhaustion of the underlying policies resulting from the payment of benefits. It appears that the settling insurers stipulated that they would not assert the defense of exhaustion in the Superior Court because they merely sought a declaration that the settlement agreements created exhaustion, but reserved their right to assert *actual exhaustion* of the policy limits in later actions. As stated in the Chute Declaration, some of the underlying policies have been exhausted since the 2005 Allocation Order, and Pepsi's recent settlements with OneBeacon and Wausau may have changed the allocations of the prior order. Further, apart from its reliance on the 2005 Allocation Order, Century has offered no persuasive evidence that the policies are not actually exhausted.

Century also asserts that equitable estoppel and judicial estoppel

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[20] The Court has taken judicial notice of the 2005 Allocation Order.

apply in this situation. However, having determined that the issue of actual exhaustion was never raised in the prior proceeding, these estoppel arguments have no basis. Further, the Cross-Defendants do not refute that the allocated shares based on the information provided to the Superior Court were binding. Thus, Century's Partial Motion for Summary Judgment is DENIED.[21]

D. Pepsi's Motion for Partial Summary Judgment as to Certain Affirmative Defenses

In a Motion for Partial Summary Judgment, Pepsi requests that the Court order that Century provide an immediate and complete defense for pending Willits suits, that Century's contractual obligation to Pepsi cannot be reduced by any equitable contribution rights Century may have, and that no past or future defense costs may be allocated to Pepsi for uninsured periods or to self-insured 1977-1985 policies issued by Third-Party Defendants Continental, Northwestern, and National Union.[22]

It is not entirely clear what, if anything, is sought in this Motion in regards to Century's duty to defend that is not already determined under the Motions already addressed. As already determined above, the Court finds that Century's acknowledgment of a potential of coverage under its policies requires that it must defend Pepsi in all of the suits in which there is a potential for coverage in their *entirety*

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[21] The Court notes that to the extent that the policies are determined not to be exhausted, the 2005 Allocation Order could have preclusive effect on the settling insurers. The Wausau court itself found that the Superior Court had "correctly apportioned defense costs." Wausau, 141 Cal. App. 4th at 401. However, the Court need not decide this issue until there has been a determination regarding exhaustion. If exhaustion is found in some or all of the policies, the allocated percentages in the 2005 Allocation Order must necessarily change.

[22] Pepsi alleges that during the period from 1977-1985, its predecessor was self-insured for the first $250,000 layer of coverage.

by paying all reasonable and necessary defense costs, despite the 2005 Allocation Order. Century may then seek contribution from settling insurers. If Pepsi is seeking an injunction, or a Court Order requiring Century to defend the suits fully, it certainly has not attempted to show any of the requisite criteria that would entitle Pepsi to such relief.

Second, Pepsi invites this Court to address issues of self-insurance if it were to reach any allocation issues now. The Court is not inclined to address issues of allocation at this stage. These issues appear suited to be addressed alongside the issue of damages for breach of the duty to defend or at a later stage in the proceedings.

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IV. CONCLUSION

The Court DENIES two of Century's Motions for Partial Summary Judgment as addressed in this opinion (Doc. Nos. 114 and 126). The Court GRANTS Century's Motions for Partial Summary Judgment to compel arbitration under § 2860(c) in accordance with this opinion. (Doc. Nos. 108 and 121). The Court GRANTS Pepsi's Motion for Partial Summary Judgment on Breach of Duty to Defend and GRANTS Pepsi's Motion for Partial Summary Judgment on Century's Affirmative Defenses to the extent that the Motion raises the same issues already addressed in this opinion and conform to this opinion (Doc. Nos. 144 and 141, respectively). The Court purposefully does not address issues of self-insurance and allocation raised in Pepsi's Motion for Partial Summary Judgment on Century's Affirmative Defenses.

IT IS SO ORDERED.

DATED: December 28, 2010

STEPHEN V. WILSON
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PEPSI-COLA METROPOLITAN BOTTLING CO., INC. **Plaintiff,**	:	
v.	:	**CIVIL NO. 10-mc-222**
INSURANCE CO. OF NORTH AMERICA, INC; and	:	
ONEBEACON AMERICA INSURANCE CO. **Defendants.**	:	

MEMORANDUM OPINION AND ORDER

RUFE, J. **January 25, 2011**

Pending before the Court is Non-Party Resolute Management Inc., Mid-Atlantic Division's Motion to Quash and/or for a Protective Order. Pursuant to Federal Rule of Civil Procedure 78, no oral argument was held. For the reasons that follow, the Motion will be denied.

I. Background

Resolute Management Inc., Mid-Atlantic Division ("Resolute"), a non-party to this case, currently pending in the United States District Court for the Central District of California, now moves this Court to quash a Rule 30(b)(6)[1] Subpoena to testify issued by plaintiff Pepsi-Cola Metropolitan Bottling Company, Inc ("Pepsi"), or, alternatively, to enter a protective order

[1] Under Fed. R. Civ. P. 30(b)(6), a "party may name as the deponent a public or private corporation . . . and must describe with reasonable particularity the matters for examination. The named organization must then designate one or more officers, directors, or managing agents, or designate other persons who consent to testify on its behalf."

excusing Resolute from presenting itself for deposition.

A brief review of the pending California litigation is necessary to the disposition of Resolute's Motion. On April 14, 2010, Pepsi sued one of its insurers, Insurance Company of North America ("INA") for its alleged failure to pay Pepsi's defense costs in a series of environmental lawsuits,[2] claiming, *inter alia*, breach of contract and bad faith.[3] Century Indemnity Company ("Century"), answered the Complaint and appeared as the defendant on behalf of INA.[4] On December 28, 2010, the California District Court granted partial summary judgment on Pepsi's motion, ruling that INA/Century had breached its contractual defense obligations through: (1) a "pattern of delaying its reimbursements to Pepsi";[5] and (2) its failure to fully reimburse Pepsi for its litigation costs.[6] The court bifurcated the determination of damages, ordering that attorneys' fees be decided in arbitration,[7] and other remaining damages be decided by a jury.[8]

On November 17, 2010, Pepsi deposed INA/Century pursuant to the Federal Rule of Civil

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[2] Id. at 3.

[3] Pepsi-Cola Metro. Bottling Co., Inc. v. Ins. Co. of N. Am., Inc., at 2, No. CV 10-2696 (C.D. Cal. Dec. 28, 2010) (doc. no. 251).

[4] INA was restructured in 1995, and was succeeded by CCI Insurance Company, which merged with Century Indemnity Company. For the purposes of this litigation, INA is the same entity as Century, and for ease of reading, shall be referred to as INA/Century throughout this opinion. See Id. at 2 n.1.

[5] Id. at 13.

[6] Id. at 19.

[7] Id. at 31.

[8] Id. at 28.

Procedure 30(b)(6).[9] Kevin Winey, an employee of Resolute, appeared as INA/Century's 30(b)(6) designee. Through Winey's deposition, and documents provided by INA/Century to Pepsi in October or November 2010, Pepsi learned that Resolute—a company located in Philadelphia, Pennsylvania—has managed all of INA/Century's claim-handling activities in connection with the underlying suits since 2004.[10] Accordingly, Pepsi issued a 30(b)(6) subpoena for Resolute, and two subpoenas for Winey's supervisors, Gregory Kelder and Daniel Brehm. Resolute produced Kelder and Brehm for half-day depositions on December 17, 2010, but refused to designate a witness for the 30(b)(6) subpoena.

Instead, Resolute filed this Motion to Quash the Subpoena, or Alternatively, for a Protective Order. In its Motion, Resolute first argues that the subpoena seeks "unreasonably cumulative and/or duplicative" information that Pepsi already had the opportunity to gather from Winey, Kelder, and Brehm.[11] Second, Resolute claims that the subpoena seeks the disclosure of irrelevant, privileged and confidential information. Finally, Resolute claims that the burden imposed by the subpoena outweighs its likely benefit. In response, Pepsi argues that the Resolute 30(b)(6) deposition is necessary to the development of its bad faith claim, and that it seeks information not yet obtained through any other discovery. The Court has considered the Motion, Response in Opposition, Reply and Sur-reply, and this matter is now ready for disposition.

[9] Def.'s Opp'n at 3.

[10] Decl. of Michael Molland, ¶ 3 ("Molland Decl.").

[11] Mot. to Quash at 7–8.

I. DISCUSSION

The Federal Rules of Civil Procedure allow the examination of a deponent concerning "any matter, not privileged, which is relevant to the subject matter involved in the pending action."[12] Relevance under Rule 26(b)(1) is therefore construed more broadly for discovery than for trial; the information sought does not need to be admissible at trial, so long as the discovery appears reasonably calculated to lead to the discovery of admissible evidence. Therefore, relevancy is not limited to the precise issues set out in the pleadings.[13] Notably, "[a] district court whose only connection with a case is supervision of discovery ancillary to an action in another district should be 'especially hesitant to pass judgment on what constitutes relevant evidence thereunder."[14] Therefore, if relevance is unclear, Rule 26(b)(1) indicates that the court should be permissive.[15]

"While broad, the scope of discovery is not boundless."[16] Courts have the discretion to limit relevant discovery under certain circumstances:

> The frequency or extent of use of the discovery methods otherwise permitted under these rules and by any local rule shall be limited by the court if it determines that (i) the discovery sought is

[12] Fed. R. Civ. P. 26(b).

[13] Oppenheimer Fund, Inc. v. Sanders, 437 US 340, 351 (1978).

[14] Truswal Sys. Corp. v. Hydro-Air, 813 F.2d 1207, 1211–12 (quoting Horizons Titanium Corp. v. Norton Co., 290 F.2d 421, 425 (1st Cir. 1961); see also Application of Zenith Radio Corp., 1 F.R.D. 627, 630 (E.D. Pa. 1941); In re Gateway Eng'rs, Inc., No. 2:09-mc-209, 2009 WL 3296625, at *3 (W.D. Pa. Oct. 9, 2009).

[15] In re Gateway Engineers, Inc., 2009 WL 3296625 at *3.

[16] Unicasa Mktg. Grp., LLC v. Spinelli, No. 04-4173, 2007 WL 2363158, at *2 (D.N.J. Aug. 15, 2007).

> unreasonably cumulative or duplicative, or is obtainable from some other source that is more convenient, less burdensome, or less expensive; (ii) the party seeking discovery had ample opportunity by discovery in the action to obtain the information sought; [or] (iii) the burden or expense of the proposed discovery outweighs its likely benefit. . . .[17]

Further, under Rule 45(d)(1), a person who has been served with a discovery subpoena may move either for a protective order under Rule 26(c) or for an order quashing or modifying the subpoena under Rule 45(c)(3). Here, Resolute has moved this court to quash the 30(b)(6) subpoena, or, alternatively, to enter a protective order excusing it from appearing at the deposition. We address Resolute's arguments in turn.

A. Resolute's Motion for a Protective Order

Under Federal Rule of Civil Procedure 26(c), it is "well-established that a party wishing to obtain an order of protection over discovery material must demonstrate that "good cause" exists for the order of protection."[18] "Good cause" to issue a protective order exists when disclosure will result in a "clearly defined and serious injury to the party seeking the protective order."[19] The alleged injury must be articulated with specificity; "[b]road allegations of harm, unsubstantiated by specific examples or articulated reasoning" are insufficient.[20]

In the present case, Resolute has not demonstrated that the subpoena would cause a

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[17] Fed. R. Civ. P. 26(b)(C)(i)–(iii).

[18] Pansy v. Borough of Stroudsburg, 23 F.3d 772, 786 (3d. Cir. 1994).

[19] Id.

[20] Id. (citing Cipollone v. Liggett Grp., Inc., 785 F.2d 1108, 1121 (3d Cir. 1986), cert. denied, 484 U.S. 976 (1987)).

"clearly defined and serious injury."[21] Although Resolute claims that the subpoena "seeks to delve into irrelevant and commercially sensitive areas of Resolute's operations, including the handling of other active cases and Resolute's business relationship with other corporate entities, all of which are privileged, confidential and protected," it identifies neither the source of the claimed privilege, nor the anticipated injuries that will result from disclosure.[22] Resolute's conclusory statements are insufficient to carry Resolute's burden to show good cause: "Absent a showing that a defined and serious injury will result . . . a protective order should not issue.[23] Therefore, the Court declines to enter a protective order excusing Resolute from answering Pepsi's 30(b)(6) subpoena.

B. Resolute's Motion to Quash

Federal Rule of Civil Procedure 45(c)(3)(A) authorizes a court to quash or modify a subpoena if it subjects a person to an undue burden.[24] "Accordingly, a District Court may quash or modify a subpoena if it finds that the movant has met its *heavy burden* of establishing that compliance with the subpoena would be 'unreasonable and oppressive.'"[25] This burden is

[21] Glenmede Trust v. Thompson, 56 F.3d 476, 483 (3d Cir. 1995).

[22] Mot. to Quash at 13.

[23] Glenmede Trust Co., 56 F.3d at 485.

[24] Rule 45(c)(3)(A) also authorizes the Court to quash a subpoena if it requires the production of confidential commercial information. Because the Court has addressed the insufficiency of Resolute's confidentiality claims, *supra*, there is no need to repeat that analysis here.

[25] Composition Roofers Union Local 30 Welfare Trust Fund, et al. v. Graveley Roofing Enter., Inc., 160 F.R.D. 70, 72 (E.D. Pa. 1995) (emphasis added).

"particularly heavy to support a motion to quash as contrasted to some more limited protection."[26] In deciding whether to grant the motion to quash, the district court must balance the relevance of the discovery sought, the requesting party's needs, and the potential hardship to the party subject to the subpoena.[27]

Here, Resolute argues that the subpoena should be quashed because "it is cumulative and duplicative, irrelevant to the issues germane to the California Coverage Action, and otherwise seeks privileged, confidential, and commercially sensitive information." In response, Pepsi argues that the subpoena topics are relevant because Resolute has been in complete control of Pepsi's litigation claims since 2004, and because "Pepsi's bad faith claim against INA is based on Resolute's decisions to decline coverage and reduce payments of Pepsi's defense costs and repeated lengthy delays in making any payments that have been made."[28] Pepsi also alleges that previous depositions indicate the need to investigate "whether the reinsurance relationship between NICO and Resolute resulted in a conflict of interest or institutional bias that caused the denial or partial denial of its claims."[29]

To determine the relevancy of Pepsi's request, it is necessary to construe the elements of its bad faith claim. Under California law, "an insurer's denial or delay in paying benefits gives

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[26] Westinghouse Elec. Corp. v. City of Burlington, 351 F.2d 762, 766 (D.C. Cir. 1965).

[27] In re Automotive Refinishing, 229 F.R.D. 482, 296 (E.D. Pa. 2005) (noting that a "[a] discovery objection based on 'undue burden' can be evaluated by considering factors such as 'relevance, the need of the party for the documents, the breadth of the document request, the time period covered by it, the particularity with which the documents are described and the burden imposed").

[28] Opp'n at 9.

[29] Opp'n at 10.

rise to tort damages only if the insured shows the denial or delay was unreasonable."[30] Because bad faith implies unfair dealing rather than mistaken judgment, a party bringing a bad faith claim must show a "conscious and deliberate act." Therefore, during the jury trial to determine damages, Pepsi must show that INA/Century unreasonably delayed and denied payments.[31] In order to gather evidence to support its claim, Pepsi must investigate both the relationship between Resolute and INA/Century and Resolute's claims handling practices. Although Resolute claims that the information sought—specifically, Resolute's operating protocols and business practices—is irrelevant to the breach of contract and bad faith allegations, this Court disagrees. To show bad faith, as opposed to mere negligence, "a review of the policies and procedures of the companies in order to determine whether those policies instructed claims handlers to act in bad faith or provided them with an incentive structure that led to bad faith actions is necessary."[32] Although it is true that "courts are reluctant to open up insurance companies to broad discovery of their internal practices and policies without some kind of prima facie showing that there is a valid reason," Pepsi has sufficiently provided evidence of the relevance of this subpoena.[33]

Resolute also argues that even if the topics sought by the Resolute subpoena are relevant, the subpoena is unreasonably cumulative and duplicative of the topics covered in the Winey, Brehm, and Kelder depositions. Thus, Resolute argues that because its involvement in the claims

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[30] Wilson v. 21st Century Ins. Co., 42 Cal. 4th 713, 723 (2007).

[31] Id. at 726.

[32] Saldi v. Paul Revere Life Ins. Co., 224 F.R.D. 169, 177 (E.D. Pa. 2004).

[33] Id. at 178.

at issue has been fully explained in previous depositions, this discovery is irrelevant and overly broad. However, Pepsi has identified the specific areas where the testimony of the prior deponents was lacking. Specifically, the deponents were unable to address the source of the delays in the payment of Pepsi's claim, Resolute's relationships with the insurers and reinsurers, and the overall scheme of decision-making at Resolute—all topics relevant to Pepsi's bad faith claim.[34] Accordingly, the proposed discovery is neither cumulative nor redundant.

III. Conclusion

Therefore, in accordance with the foregoing reasons, the Court will deny Resolute's Motion to Quash and/or for a Protective Order. An appropriate order follows.

[34] See Opp'n at 11–13.